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US Multinationals Overseas Profits: Ireland's patent income tax-exemption may fund over 5% of Irish Government annual spending in 2006
By Finfacts Team
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HOW MICROSOFT REDUCES ITS GLOBAL TAXES

The Wall Street Journal said in its report two weeks ago : "Ireland's citizens may not have heard of Round Island One, but they benefit greatly from its presence. Last year the unit handed the government of this small country of four million citizens more than $300 million in taxes.

The citizens of other nations where Microsoft sells its products are less fortunate. Round Island One provides a structure for Microsoft to radically reduce its corporate taxes in much of Europe, and similarly shields billions of dollars from U.S. taxation.

Giant U.S. companies whose products are heavily based on their innovations, such as technology and pharmaceutical firms, increasingly are setting up units in Ireland that route intellectual property and its financial fruits to the low-tax haven -- at the expense of the U.S. Treasury."

The Journal wrote: "Much of Round Island's income is licensing fees from copyrighted software code that originates in the U.S. Some of the rights to these lucrative assets end up in Ireland via complex accounting rules on intellectual property that the Treasury is now seeking to overhaul. The Internal Revenue Service said it is also looking closely at how companies account for such transactions.

In a statement, Microsoft said its European units "report and pay significant amounts of taxes" and that Microsoft "is fully compliant with the tax laws of the United States and all other countries."

Through a key holding, dubbed Flat Island Co., Round Island licenses rights to Microsoft software throughout Europe, the Middle East and Africa. Thus, Microsoft routes the license sales through

Ireland and Round Island pays a total of just under $17 million in taxes to about 20 other governments that represent more than 300 million people."

Microsoft's effective global tax rate fell to 26 percent in its last fiscal year from 33 percent the year before. Nearly half of the drop was attributed to "foreign earnings taxed at lower rates," Microsoft said in a Securities and Exchange Commission August filing. Microsoft leaves much of its profit in Ireland, including $4.1 billion in cash, avoiding U.S. corporate income taxes. But it still can count this profit in its earnings.

IRELAND TOP LOCATION OF US MULTINATIONALS' PROFITS

Ireland is the world's most profitable country for US corporations, according to analysis by US tax journal Tax Notes. In a study by the journal's Martin Sullivan that was published in 2004, it was found that profits made by US companies in Ireland doubled between 1999 and 2002 from $13.4 billion to $26.8 billion, while profits in most of the rest of Europe fell. In his analysis Sullivan termed Ireland a 'semi-tax haven' for US firms, because firms are involved in real productivity in contrast with locations such as Bermuda.

Between 1999 to 2002, US multinational corporations increased profits in countries with no taxes or low rates by 68% while sharply reducing profits recorded in countries where they engage in substantial business activity, the study published in the journal Tax Notes shows.

In 2002, US companies reported $149 billion of profits in 18 tax-haven countries, up 68% from $88 billion in 1999, according to Tax Notes, which analyzed the most recently available Commerce Department data. This compares with a 23% increase in total offshore profits earned by US multinationals during the same period-total profits of US multinationals' foreign subsidiaries around the world stood at $255 billion in 2002.

According to the New York Times, Commerce Department data not referred to in the Tax Notes study, suggest that US companies took 17 cents of each dollar of worldwide profits in tax havens in 2002, up from 10 cents in 1999.

Tax Notes shows that for each dollar of profit taken in Luxembourg in 1999, US corporations took $4.56 of profit in 2002. The result for Bermuda was $2.96; for Ireland $2.01; and for Singapore $1.72. These countries are viewed as tax havens or partial tax havens. For UK, each dollar of profit taken in 1999 was equal to 67 cents in 2002; for Germany, it was 46 cents.

A New York Times report last year notes that, in their public filings, companies are often unclear about what percentage of their profits comes from domestic operations as opposed to foreign operations, and they almost never discuss profit-shifting. For example, Pfizer, the pharmaceutical giant, said in its 2003 annual report that as of the end of last year, it had not made a United States tax provision on what it called $38 billion of unremitted earnings at its international subsidiaries. It was not clear whether that money was actually earned by the international subsidiaries or by Pfizer's operations in the United States and later shifted to those subsidiaries for tax purposes, and a Pfizer spokesman declined to provide any details or comments to the Times.

In October 2004, the Financial Times said that from 1994 to 2003, foreign profits of the six largest US pharmaceuticals companies went from 38 per cent of their overall income to more than 65 per cent. At the same time, the taxes paid on those profits fell from a rate of 31 per cent to 17.5 per cent, just half the US corporate tax rate.

In the case of the drug companies, the growing share of profits booked abroad - most of it in low-tax jurisdictions - does not reflect any significant shift in where those companies do business. Even as their overseas share of profits nearly doubled over the past decade, their overseas sales grew from just 40 to 43 per cent.

IRISH PATENT EXEMPTION

A & L Goodbody, one of Ireland's top law firms, says that patented inventions are a large source of revenue in the pharmaceutical industry. Ireland's tax exemption in respect of certain patent royalties, has been one of the driving factors behind investment by pharmaceutical multinationals, principally from the US, in the Irish economy.

Irish tax legislation provides an exemption from tax for income derived from "qualifying patents" when received by a person resident in Ireland and not resident in any other country. A "qualifying patent" is defined as a patent in relation to which the research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the invention, the subject of the patent, was carried out in Ireland.

A & L Goodbody says that the taxation reliefs to be derived from patented inventions goes further than to exempt the income from patent royalties from tax. Certain distributions by companies made out of income from certain patents which has been disregarded for corporation tax purposes, are themselves disregarded for the purposes of income tax on the part of a shareholder. This has very wide implications for investors in pharmaceutical companies considering carrying out any of their research and development in Ireland.

Maximising Relief for Patent Income

A & L Goodbody says that individuals or companies interested in knowing how to maximise benefits available under the patent royalty exemption should consider the following:

* establishing a separate company to do research and development work for the qualifying patent which will apply for, and hold the relevant patents; and
* this company should so far as is commercially viable, grant licences to unconnected third party users.

Patent royalties received by this company will be exempt from Irish corporation tax, and dividends paid on the ordinary shares of the patent holding company, or on other shares but only to the inventor or co-inventor, will be exempt from Irish income tax in the hands of the shareholders.

Click for more detail from A & L Goodbody.

Ireland's industrial development agency IDA Ireland, says that Ireland offers one of the most beneficial corporate tax environments in the world.

A corporation tax rate of 12.5% applies to all corporate trading profits. The tax position of companies carrying out approved activities prior to 31 July 1998 will remain unchanged at 10% up until 2010.

European Corporate Tax Rates for substantial distributed trading profits

Ireland	12.5%
Cyprus	10%
Latvia	15%
Lithuania	15%
Hungary	18%
Poland	19%
Luxembourg	22.88%
Portugal	25%
Slovenia	25%
Estonia	22%
Germany	26.38%
Czech Republic	26%
Sweden	28%
Finland	29%
Slovakia	19%
Denmark	30%
UK	30%
Italy	33%
France	33.33%
Belgium	33.99%
Austria	25%
Netherlands	34.50%
Greece	32%
Malta	35%
Spain 3	5%

Source - Deloitte & Touche, 2005